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Agenda Item 3b

April 12, 2011

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: SB 27 (Simitian) – As Amended March 3, 2011
Pension Spiking and Return to Work Limits

Sponsor: Author

II. PROGRAM: Legislation

III. RECOMMENDATION: Support, with suggested amendments to conform SB 27 with current policies and procedures.

IV. ANALYSIS:

Summary

This bill would provide for California Public Employees' Retirement System (CalPERS) and the California State Teachers' Retirement System (CalSTRS) effective July 1, 2012 - that any change in salary, compensation, or remuneration principally for the purpose of enhancing a member's retirement benefits, would not be included in the calculation of a member's final compensation for purposes of determining that member's defined benefit. It would also prohibit retirees, effective January 1, 2013, from returning to work or from otherwise performing service for any employer participating in the retirement system from where the individual retired for at least 180 days after the date of retirement. The bill also makes conforming changes to the Public Employees Retirement Law (PERL).

Background

CalPERS has demonstrated a long-term commitment to provide protection against the unsound treatment of compensation for the purpose of enhancing retirement income. CalPERS sponsored legislation, (SB 53, Russell) in 1993, which enacted many of the same practices proposed in SB 27. Among other things, SB 53:

- Provided a definition of compensation
- Provided for full funding of member benefits
- Reduced the ability to manipulate compensation

- Prohibited the use of cash conversions, final settlement pay and termination pay for purposes of calculating members' retirement benefits;
- Provided the CalPERS Board with clear oversight of benefits
- Repealed the ability of CalPERS employers to hire retired annuitants for a limited but indefinite duration
- Simplified internal audit practices

Existing law also generally requires members that retire before normal retirement age to observe a 60-day break in service before returning to work for a CalPERS-covered employer. Existing law also prohibits retired annuitants from working more than 960 hours in a fiscal year without an approved exemption filed by their employer.

Proposed New CalPERS Regulations

Current law allows only compensation earnable, which consists of an employee's payrate and special compensation, to be reportable to CalPERS for purposes of calculating retirement benefits. Additionally, the PERL requires that a member's payrate be shown on a publicly available pay schedule, that special compensation be limited to items included in a labor policy or agreement, and all records establishing and documenting payrate and special compensation be publicly available.

In the past, employers have not uniformly adhered to these policies, which has increased workload for CalPERS staff and employers as well as inconsistencies in implementing the law. To ensure consistent application by CalPERS employers, the Board approved regulations for publication at its December 2010 meeting. These regulations are designed to provide CalPERS employers with the details necessary to ensure compliance, while also providing CalPERS staff with additional authority to determine the correct amount to be reported in disputed cases.

These proposed regulations will require that the payrate or item of special compensation be listed on a schedule or in a document that:

- Has been duly approved and adopted by the employer's governing body in accordance with requirements of applicable public meeting laws;
- Has been posted at the office of the employer or immediately accessible and available for public review from the employer during normal business hours or posted on the employer's internet website;
- Indicates the effective date and date of any revisions;
- Is retained by the employer and available for public inspection for not less than five years;

- Does not reference another document in lieu of disclosing the payrate or item of special compensation;
- For payrate, identifies the position title for every employee position, shows the payrate for each position, and identifies the time base;
- For special compensation, indicates the conditions for payment.

These regulations will benefit the public, CalPERS employers, members and staff by reducing the uncertainty around whether or not a member's payrate and special compensation was properly noticed and approved by the employing agency.

Proposed Changes

As it relates to CalPERS, SB 27 would:

- Require the end of career pay increases to members who are not part of a group or class to be limited to the increase provided to similarly situated members in the closest related group of their employer or to the entire membership classification, during the applicable final compensation period and preceding two years.

- Require employers to immediately provide notice to the CalPERS Board, in the manner prescribed by the system, when changes in their labor policies or agreements will impact payrate or special compensation, along with any additional information concerning any member or employer that the Board may require in the administration of the system, and authorize the Board to assess a reasonable fee on employers that fail to do so.

- Require pay rate to be reported separately from special compensation.

- Restate in the PERL that employers have the ability to request the addition of a new special compensation item to Regulation 571 by filing a petition to adopt, amend or repeal a regulation pursuant to Section 11340.7.

- Authorize the Board to recover its audit and adjustment costs from employers that knowingly fail to report employee compensation correctly or fail to identify the pay period in which compensation was earned.

- Requires determinations on written requests to whether specific items of compensation meet the current definition of special compensation be completed within 90 days of receipt of all information required by the Board.

- Beginning January 1, 2013, prohibit a public employee from returning to work or from otherwise performing service for an employer covered by their retirement system for 180 days following his or her date of retirement, either as an employee, an employee of a third party, or an independent contractor.

- Require newly retired CalPERS members who violate the 180-day waiting period to be automatically reinstated into active service where directly employed by a CalPERS-covered employer, or to abandon a position where services are provided as an employee of third party or as an independent contractor for a CalPERS-covered employer.

Legislative History

2010 SB 1425 (Simitian), As Enrolled—Would have provided for all State and local public retirement systems in California, effective July 1, 2011, that any change in salary, compensation, or remuneration principally for the purpose of enhancing a member's retirement benefits would not be included in the calculation of a member's final compensation for purposes of determining that member's defined benefit. It would also have prohibited retirees effective January 1, 2012, from returning to work or from otherwise performing service for any employer participating in the retirement system where the individual retired from for at least 180 days after the date of retirement. This bill was vetoed by the Governor because it was double-joined with AB 1987, which he also vetoed. *CalPERS Position: Support*

1993 Chapter 1297 (SB 53, Russell)—Narrowed and clarified what would be considered compensation earnable to be included in CalPERS members' final compensation calculations. Among other things, it prohibited items included in final settlement pay from being included in the calculation of members' final compensation, and that pay increases provided in members' final compensation period must apply to all employees in that class in order to be recognized. *CalPERS Position: Sponsor*

1990 Chapter 1544 (SB 2470, C. Green)—Required the CalPERS Board of Administration to conduct a study on methods to improve the accuracy of contracting agency payroll reporting procedures. It also approved the addition of six CalPERS audit positions. *CalPERS Position: Sponsor*

Issues

1. Arguments in Support

   According to the author:

   "Recent news reports have highlighted the actions by a small percentage of public employees who have intentionally, but legally, manipulated their final compensation for purposes of gaining a larger pension benefit. This bill institutes uniform laws for all public retirement systems that will help to curtail an individual from taking extraordinary steps to enhance their retirement benefits (i.e., "spiking")."

   "Senate Bill 27 is designed to correct abuses that impose an undue burden on both the taxpayers and employees in the system, as well as erode public support for reasonable public employee pensions."

   Organizations in Support: State Controller, California Association of Highway Patrolmen, Glendale City Employees Association, Organization of SMUD Employees, Retired Public Employees Association, San Bernardino Public Employees Association, San Luis Obispo County Employees Association, Santa Rosa City Employees Association, SEIU Local 1000.

2. Arguments in Opposition

   Arguments in opposition are focused on the 180 day prohibition on returning to work as a retiree. Police and sheriffs note that after a six-month break in service, an officer must re-undergo background checks that are costly and time-consuming.

   The Humboldt County Superintendent of Schools expresses concerns relative to the requirement for retirees to wait 180 days before returning to employment with the public employer and recommends allowing emergency reemployment in rural school districts: "The waiting period can place a specially qualified person in a rural setting into the untenable position of retiring and leaving the students without their services, or forsaking retirement."

   Similarly, the California Faculty Association would remove its opposition if the bill were amended to exempt its Faculty Early Retirement Program, which has been included in the memorandum of understanding between the California State University and CFA for "nearly two decades," from the 180 day prohibition on working after retirement.

Organizations in Opposition: Association of California School Administrators, California Police Chiefs Association, California State Sheriffs' Association, Small School Districts' Association.

Organizations Opposed Unless Amended: California Association of Joint Powers Authorities, California Faculty Association, California State Association of Counties, Humboldt County Superintendent of Schools

3. <u>Potential Conflicts With the Annual CalPERS Omnibus Bill</u>

Among other things, SB 27 would amend the PERL to require employers to:

- make salary schedules publicly available in order to be used for retirement purposes only;
- report special compensation separately from payrate, and
- other provisions regarding special compensation.

CalPERS staff strongly support these changes and have recently considered requesting the Board to sponsor legislation to enact them. The annual CalPERS omnibus bill, AB 1028 (PER&SS) amends this same section of the PERL in order to authorize specified changes to the definition of "payrate." While these proposed changes do not conflict with each other, because they are not included in both bills, there is a risk of one bill chaptering out the amendments made by the other bill. Staff recommends including both sets of amendments in both bills in order to eliminate this possibility, and increase the likelihood that all the proposed changes become law.

4. <u>Further Clarifications to Conform SB 27 to CalPERS Policies and Procedures</u>

In light of the recent proposed change in regulations, staff also recommends amendments to eliminate the requirement that employers provide immediate notice to the Board of any change that may impact a member's payrate or special compensation. The proposed CalPERS regulations would enhance transparency, accessibility and disclosure by clarifying and specifying the requirements for publicly available pay schedules and labor policies or agreements. Therefore, these regulations would negate the need for all updated documents to be submitted to CalPERS reducing administrative cost and workload on the retirement system and employers.

SB 27 also requires that CalPERS respond to written requests to review special compensation within 90 days. CalPERS staff currently measures a number of member and employer service level goals that are reported to the Board on a quarterly basis. None of these measurements are set in statute, therefore staff is concerned with setting a precedent of putting service level goals in statute which could limit CalPERS flexibility to respond to changing workload and staffing levels, such as furloughs. Therefore, staff would like to work with the author to delete a reference to a specific time limit in the statute.

These changes would allow CalPERS to continue to respond to employer inquiries regarding special compensation items when the employer cannot determine whether it is creditable under existing regulations. Should the author reject these proposed changes, staff recommends that the effective date of the new notice and review processes be delayed until the new my|CalPERS system-wide database implementation is complete and stabilized.

5. <u>180-day Waiting Period After Retirement</u>

Currently, only CalPERS members who retire prior to reaching normal retirement age are required to have a break in service of 60 days before returning to work as a retired annuitant. SB 27 would increase that break to 180 days and apply it to all retirees, regardless of age, who return to work for any CalPERS State, Public Agency, or School District Employer. Retired annuitants that violate the 180-day prohibition would be reinstated to active member status. Members performing service for a CalPERS-covered employer as an employee of a third party or as an independent contractor would be required to cease such work immediately. Identification of violations will likely only be accomplished through on-site employer audits long after any violation occurred.

In addition, this waiting period, would impact Faculty returning to work in academic positions under the Faculty Early Retirement Program (FERP), which was established through collective bargaining and ratified by the Legislature in GC 21227. Participants in FERP are considered retired, but are eligible to continue working and receive a pro-rated check based on the position and salary held at the time of retirement. Faculty members participating in FERP can work the lesser of 960 hours or 50 percent of the hours they were employed during the last fiscal year prior to retirement. Like retired annuitants the only break in service required to participate in FERP is the “bona fide” separation of 60 days required by the IRS for participants under the normal retirement age.

6. <u>Legislative Policy Standards</u>

The Board’s Legislative Policy Standards recommend a support position on proposals that add protection to the trust. SB 27 attempts to ensure consistency in the treatment of compensation earnable among CalPERS and CalSTRS and seeks to discourage pension spiking; therefore staff recommends the Board adopt a **support, with suggested amendments** to conform SB 27 to current CalPERS policies and procedures.

V. STRATEGIC PLAN:

This item is not a specific product of the Annual or Strategic Plans, but is a part of the regular and ongoing workload of the Office of Governmental Affairs.

VI. RESULTS/COSTS:

Program Costs

None identified. The primary intent of the bill is to prevent recognition of any change in salary, compensation, or remuneration principally for the purpose of enhancing a member's retirement benefits. To the extent that this goal is realized, it will have a positive fiscal impact on CalPERS employers. However, because CalPERS is largely in compliance with the changes proposed by the bill, the anticipated impact on employer's benefit costs should be relatively minor.

Administrative Costs

If the author adopts the amendments recommended by CalPERS staff, there will be minor costs associated with adjusting the existing CalPERS anti-spiking efforts, administering the new limitations on working after retirement, and with monitoring and enforcing these programs as required by the legislation. These costs would be absorbable with existing resources.

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